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THE DUAL SYSTEM OF THE 70'S: A VIEW FROM THE COMPTROLLER'S OFFICE

REMARKS OF JAMES E. SMITH
COMPTROLLER OF THE CURRENCY
BEFORE THE ANNUAL CONVENTION OF
THE AMERICAN BANKERS ASSOCIATION
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It is a special honor for me to address the American Bankers Association in my new regulatory capacity. I very much cherish the memories of my past direct relationship with this Association, and the friendships that I enjoy with so many of the members.

Some may believe that this prior relationship will limit my capacity for objectivity. I anticipate no such incapacitation! Indeed, the rapport which I hope exists between this Comptroller and the banking industry should help, not hinder, the achievement of objectives that are in the public interest. It has been my personal experience that mutual trust and confidence are important -- perhaps essential -- ingredients for the effective solution of tough issues.

There can be no doubt that the banking industry faces some tough issues. The last several years have seen a great deal of effort devoted to re-thinking the purposes and functions of our financial institutions and their regulators. That effort is a healthy one that can yield substantive public benefits.

In overseeing banks' pursuit of their purpose, regulators must always be congnizant of the fact that no sector of the financial community impacts quite so broadly or directly on human aspirations and commercial development as does banking. In urban America, the direct correlation between bank performance and the economic vitality of a community may be somewhat obscured. In less populous areas

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like my native South Dakota, that inextricable tie can be observed in bold relief. A prosperous community is highly reliable evidence of progressive banking.

Thus, regulators have an obligation to permit banks the operational flexibility they require to respond to changing needs. Dogmatic and unbending regulation should not be equated with sound bank supervision. Adherence to the status quo is often a "cop-out" for those who really do not want to grapple with the complexities of change.

Determining the appropriate regulatory posture is an extraordinarily difficult task. No regulator has a valid claim to omniscience. Indeed, our profession is more an art than a science, and as such relies heavily on experimentation. In that regard, I, as a bank regulator, am very fortunate to be part of the dual banking system.

The greatest single advantage offered by the duality of our system is its capacity to foster fruitful experimentation. In effect, we have 51 banking laboratories. Results of changes in regulatory stance soon become apparent to all authorities. False turns can quickly be amended without widespread impact; salutary changes can spread rapidly into other jurisdictions.

That competition between the National and State systems, and among State systems, is thoroughly consistent with the precepts of Federalism. It has not led to a competition in laxity. Instead, it has engendered a healthy march away from the stultifying protectionist mode of regulation that was an understandable outgrowth of the Great Depression.

Unfortunately, because of lack of resources, some State banking authorities are forced to lean heavily upon the Federal Reserve and the Federal Deposit Insurance Corporation for aid in bank supervision. I personally hope that, over time, such States acquire a greater independent regulatory capacity. When that day arrives, duality will have been materially strengthened. I commend Chairman Wille and the Conference of State Bank Supervisors for their experimental efforts to achieve more independence for State banking agencies.

I want to assure each State banking authority that in all supervisory matters, we stand ready to cooperate fully and to exchange the

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fruits of our experiences. For example, we are undertaking a fundamental and detailed evaluation of our examination function to assure that our procedures are keeping pace with changes in the industry. In that evaluation, we expect to consult fully with both State and Federal regulatory colleagues, and will, of course, share its results.

The current controversy over deposit reserve requirements revolves in part around the dual system. If a case can be made for strengthening the Federal Reserve's ability to shape monetary results more precisely, we must, of course, be sensitive to that need. However, we must give no less attention to the importance of preserving our dual banking system.

The current debate involves men of good will on both sides. I believe that solutions can be found that will fulfill both important objectives. No matter how much time it takes we must not be satisfied with a solution that sacrifices one objective to gain the other.

For all of its flexibility, our dual banking system does not provide a full choice of structural options in a number of States. The principal gap is a lack of branching powers. I believe that the public interest can be best served if the banking authorities have the flexibility to employ all four structural options: chartering a new bank; allowing an existing bank to branch; allowing two or more existing banks to merge; and allowing expansion by holding company acquisition.

Possession of the branching option is crucial. Many small communities can have convenient access to a banking office even if the local market cannot support an independent bank. Large communities can reap the benefits of greater competion. Developing areas can experience a more rapid infusion of banking services; decaying areas need not witness a complete withdrawal of banking offices. Branching permits, via merger, a flexible and efficient means for handling management succession problems without interrupting the flow of banking services. Regulators facing emergency problems are able to utilize the merger route to solve them.

Availability of the four major structural options is fully consistent with dual banking. State authorities yield no additional powers to Federal authorities.

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I am pleased that we are witnessing today a gradual movement among the States toward granting banking authorities fuller use of these structural options. Liberalizations of branch laws have been enacted in Arkansas, Georgia, New Jersey, and New York. Authorities in Pennsylvania are actively sponsoring a less restrictive branching bill.

Significant steps have been taken to liberalize the use of facilities: a new facilities law is on the books in Florida; in Kansas the number of services available at a facility has been expanded; and in Nebraska the permissible number of facilities per bank has been increased.

Other types of State initiatives have also given bankers new flexibility in their branching options. The availability of the automated teller has prompted significant re-examination of branching statutes. Such machines are finding widespread public acceptance. They are, or soon will be, operating as free standing installations in Connecticut, Ohio, North Carolina, New Jersey and New York. In Oregon, the State legislature explicitly authorized their use, after the courts upheld a restrictive regulatory interpretation. In Ohio, the State banking authority has tried to promote their use by exempting them from the branch application process. If that effort is successful, we will all watch the experiment closely.

The record has not been without reversals for the consumer of banking services, however. In Montana, a unit banking state, a law permitting a bank to operate another bank acquired by merger as a branch was recently stricken from the books.

In Illinois, some banks pressed by economic circumstances have sought to relocate. After an intensive study, our Office denied such a relocation application as not being in the public interest. How much easier it would be if banks in large urban areas could move their headquarters while operating their former head offices as branches! The State banking authority prepared, earlier this year, a bill to that effect. It was regrettably defeated in legislative committee.

The merits of interstate banking operations deserve consideration. Mr. Harry Albright, New York State Superintendent of Banks, has reported an encouraging response to his proposal for reciprocal banking privileges across state lines.

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There has been progress toward the removal of barriers blocking the entrance of foreign banks. Recently, State legislatures in Illinois and Washington enacted statutes permitting the establishment of branches of foreign banks within their borders. Pressures are building for a comparable law in Pennsylvania.

Despite all that progress in bank structure options, much remains to be done. Consistent with my own legal responsibilities, I will exercise the authority of my office in a manner that will not jeopardize continued progress. I will not employ contrived and tortured interpretations of State law to advance my personal judgment that branch banking is an essential element of modern, progressive, full-service banking. However, I have no intention of surrendering my right of free speech! I shall be forthright in my public declarations as to the absolute need for every state to have flexible laws on banking structure.

My concern with attaining structural flexibility for banking stems from my belief that structure governs the performance of the industry to a considerable extent. By performance, I am simply referring to the degree to which the banking industry accomplishes its basic public purposes.

One measure of performance is responsiveness. For an industry as constrained by regulation as banking, I think its record of responsiveness to both new customer demands and to new technology is remarkable.

A number of financial activities that either were not engaged in or were relatively insignificant 15 years ago have become important today. These include direct lease financing, factoring, data processing, investment advisory services, and various specialized types of consumer lending, including credit card programs.

The Office of the Comptroller of the Currency has consistently encouraged National banks to react positively to developing financial needs. This course has not been without controversy. Litigation has been common as legal frontiers were explored. I believe this process is a healthy one, and under my stewardship the Office will continue to offer encouragement and support to constructive innovation. We do not seek litigation, but where public benefits are clearly at stake we will not be intimidated by the threat of litigation.

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Our Office is also going to encourage -- in fact, to insist -- that all National banks serve their consumer customers in an equitable and non-discriminatory manner. We have begun an effort to intensify our supervision of compliance with Federal and State consumer protection statutes. To determine how we can best fulfill our responsibilities in this important area, we will be consulting with banking and consumer affairs authorities in the States. Discriminatory or deceptive practices have no place in our system, and we do not intend to allow them to exist. Fortunately, most bankers agree fully with us.

The Administration proposals for financial reform are another effort to improve the responsiveness of our financial institutions to the needs of the public. Structural reform of our financial institutions is absolutely necessary. The capacity of our system to perform its intermediation function during all phases of the economic cycle must be strengthened.

Regulated ceilings for deposit rates have proved to be both inadequate in their protection of the deposit institutions and unfair in their effect on deposit customers. We must move with all deliberate speed to eliminate this price-fixing mode of regulation. It is appropriate to augment the powers of the thrift institutions to serve household and consumer needs before rate regulation is totally withdrawn. Added powers for the thrift institutions will make it possible for them to compete with banks on essentially equal footing for household deposits. Increasingly, all institutions will be looking to consumer deposits as a stabilizing element in their deposit structure.

Banks not only live in regulatory and market environments, but also in a technological one. Responsiveness and adaptability to technological change is a requisite for retention of a competitive position. Failure to adapt leads to higher costs for some services and an inability to offer others. The banking industry deservedly receives high marks for the imaginative manner in which it has harnessed the computer revolution. In one manner or other, it has found ways to bend computer technology to its purposes, and thereby to reshape its own destiny.

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Another measure of banking's responsiveness to public needs is its commitment to fostering equal opportunity. I would like to commend the efforts of this Association and its member banks directed toward the development and expansion of minority-owned businesses. I understand that you are ahead of your schedule in meeting the goal of $1 billion in loans to minority businesses over a five-year period. MinBank is beginning to make investments in minority banks to augment their capital.

Those efforts are a good start, but there is need for still greater effort. Banks, bank trade associations, and the banking agencies must push on, and create ever more employment and ownership opportunities in banking for members of minority groups. The number of minority banks has about doubled in the past four years, while their assets have tripled. A major barrier to further progress is an inadequate supply of experienced management personnel. I would like you to consider -- either as an association or as individual banks -- the development of a lend-lease program that would provide management talent during the first years of minority bank operations. Such a program would need to include firm guarantees to the "leased" personnel that they would not lose their place in the batting order at their home institution.

In conclusion, let me affirm that I am optimistic about the future of the banking industry and its ability to achieve its essential purpose; that is, to bring a full array of financial products and services to all individuals and to all businesses in a convenient manner and at a reasonable cost.

In carrying out its mission, I believe the industry, aided by the duality of the system, will be fully responsive to new needs as they emerge and to new possibilities for service created by further technological developments.

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